Blank Page

FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 46.

STATE OF WISCONSIN and ELMER E. BARLOW, as Commissioner of Taxation of the State of Wisconsin,

Petitioners,

vs.

J. C. PENNEY COMPANY, a Delaware Corporation,

Respondent.

PETITION OF RESPONDENT FOR REHEARING AND BRIEF IN SUPPORT THEREOF.

W. H. DANNAT PELL,
ROSWELL DEAN PINE, JR.,
G. BURGESS ELA,
Attorneys for Respondent.

Blank Page

Supreme Court of the United States,

OCTOBER TERM, 1940.

No. 46.

STATE OF WISCONSIN and ELMER E. BARLOW, as Commissioner of Taxation of the State of Wisconsin, *Petitioners*, *against* J. C. PENNEY COMPANY, a Delaware Corporation, *Respondents.*	

PETITION FOR REHEARING.

TO THE HONORABLE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES.

Comes now the above named J. C. Penney Company, a Delaware corporation, and presents this, its petition for a rehearing of the above entitled cause, and, in support thereof, respectfully shows:

I.

This Court in its opinion dated December 16, 1940 reversed the judgment of the Supreme Court of Wisconsin reported in 233 Wis. 286 (1940). As we apprehend the substance of the opinion of the majority of this Court it has held the Wisconsin Privilege Dividend Tax to be in

substance an additional or supplementary tax upon corporate income. In its opinion this Court said:

> "* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out."
>
> "* * * * *
>
> "Had Wisconsin, as part of its price for the privileges it afforded foreign corporations within its borders, explicitly provided for a supplementary tax on the Wisconsin earnings of such corporations, but postponed liability for the tax until such earnings were to be paid out in dividends, the power of Wisconsin to do so would hardly be questioned. * * *"

This Court further stated that it would itself determine whether the tax transgressed constitutional barriers from its incidence and effect and not from the name given to it by the state legislature or its characterization by the Supreme Court of the state. Following the quotation above set forth it said:

> "* * * But because the legislative language ran 'For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state' the court below raised the barrier of the Fourteenth Amendment. Respondent is a Delaware corporation having its principal offices in New York; its meetings are held in the latter state where the dividends are voted and the dividend checks are drawn on New York bank accounts. Since the process for declaring dividends and the details attending their distribution among the stockholders transpired outside Wisconsin, although the exaction was apportioned to the earnings derived from Wisconsin, the state

court concluded that the tax was an attempt by Wisconsin to levy an exaction on transactions beyond Wisconsin's borders.

"The case thus reduces itself to the inquiry whether Wisconsin has transgressed its taxing power because its supreme court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax on the privilege of declaring dividends rather than a supplementary income tax.

'A tax is an exaction. Ascertainment of the scope of the exaction—what is included in it—is for the state court. But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction. 'In whatever language a statute may be framed, its purpose must be determined by its natural and reasonable effect.' Henderson *v.* Mayor of N. Y., 92 U. S. 259, 268. Such has been the repeated import of the cases which only recently were well summarized by the guiding formulation for adjudicating a tax measure, that 'in passing on its constitutionality we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it.' Lawrence *v.* State Tax Commission, 286 U. S. 276, 280.

"The Constitution is not a formulary. It does not demand of states strict observance of rigid categories nor precision of technical phrasing in their exercise of the most basic power of government, that of taxation. For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. * * * ".

II.

We assume for present purposes that this Court is steadfast in its intent to pass upon the constitutional validity of the tax under consideration in the light of its substantial effect rather than upon the basis of the verbiage

used by the Wisconsin legislature and the construction placed upon it by the Supreme Court of Wisconsin. The point which we wish most particularly to stress upon a rehearing of this case is that if we are to look to the incidence and practical effect of the Privilege Dividend Tax, it must be regarded as an income tax collectible at the source imposed upon respondent's stockholders and not as a supplementary income or franchise tax imposed upon the corporation, and that it is accordingly unconstitutional as to stockholders residing outside of the State of Wisconsin. In other words our contention is that this Court after determining to look beyond the descriptive verbiage in which the tax was clothed erred in determining its true nature and incidence. We believe that this was undoubtedly due to the numerous other closely contested points involved in this case and to the fact that this crucial question upon which we now wish to be heard was, for reasons hereinafter set forth, neither briefed nor argued by counsel.

In the brief annexed hereto, we have presented the arguments with respect to which we wish to be heard further. We submit that if this case is to be disposed of upon the basis of the incidence and practical effect of the tax, the question before this Court for determination is not whether the State of Wisconsin may impose an additional income tax upon J. C. Penney Company but whether it can impose an income tax upon its non-resident stockholders and that upon rehearing this issue should be met and disposed of.

This question is dealt with in Point I of our annexed brief. We feel that the arguments there presented render it clear beyond question that the tax cannot properly be considered to be a corporate tax, and respectfully urge that the Court give them its careful consideration. In the event that this Court shall agree with our contention that the tax is invalid as to stockholders of the respondent residing outside of the State of Wisconsin, a satisfactory basis of apportionment is set forth in the record (R. 9).

Our reasons for urging that the tax is not in effect a corporate tax are based upon the provision in the law requiring the tax to be deducted from dividends payable to stockholders. It occurs to us that this Court may in its opinion have meant to hold that this provision of the law might be entirely disregarded. We respectfully submit, however, that such a ruling certainly is not logically proper. *Under the guise of determining the true incidence and effect of a state law it surely is not proper for this Court to alter the law to such an extent as to actually impose the tax upon a different person or entity than was obviously intended by the state legislature.*

There are several additional points which were either not made in our original brief or to which sufficient attention may not have been there devoted and with respect to which we would like to present further arguments. The first of these is that the incidence of the Privilege Dividend Tax is not upon the earning of income by the corporation and that if this Court has determined to abandon the distinction between subject and measure in the field of franchise taxation, the method adopted in dealing with a particular case should be to determine whether the tax is valid as a direct imposition and not to assume that it is because it was formerly considered proper to include its subject as an element in the measure of a franchise tax.

We have also indicated in the said brief under Point III that the language in this Court's opinion with respect to the exemption of dividends from personal income taxation in Wisconsin does not seem to us to be entirely accurate. The exemption is not allowed at all to stockholders of corporations such as respondent which derive less than fifty per cent of their income from Wisconsin. The law does not impose a progressive tax upon dividends as was the case in *Welch* v. *Henry*, 305 U. S. 134 (1938) and a careful comparison of it with the law there involved discloses that the Privilege Dividend Tax was carefully designed to allow

large stockholders in Wisconsin corporations to avoid paying a graduated personal income tax and surtax upon dividends received and not to remedy that situation as might be assumed from the opinion of this Court. We have also contended that the large burden and difficulties of administration which the tax imposes upon respondent are entirely unwarranted by the amount of tax collected.

In view of the summary of our argument here presented, we have not prepared a formal summary of argument as a part of the brief annexed hereto.

III.

The contention that the Privilege Dividend Tax is in substance a personal income tax upon stockholders was not dealt with in our principal brief because it seemed immaterial to the issues raised. In the brief filed on behalf of the State of Wisconsin and its Commissioner of Taxation the construction of the tax by the Supreme Court of Wisconsin was not attacked; there was no contention that the Privilege Dividend Tax should be construed as a supplementary income tax imposed upon corporations. The construction upon which this Court based its opinion first appeared in the form of a question which Mr. Justice Frankfurter asked counsel for the State upon the argument of the appeal.

The situation is, therefore, that the case was decided by this Court upon the basis of a construction which was never presented, briefed or argued by counsel except as it may have been argued extemporaneously by counsel in reply to questions of Mr. Justice Frankfurter. Were it not for the fact that a question of the constitutionality of a state statute was involved, it seems quite unlikely that this Court would have taken the initiative and reversed a judgment upon a ground contrary to the construction of the Court below, and not urged upon it by petitioners' counsel. Broader considerations may require the application of a different rule

in a case involving the constitutional validity of a state law. In the interest of an orderly and fair procedure, however, a rehearing should be permitted where the result of the deliberations of this Court is to dispose of a case of the highest importance upon a basis not presented by counsel. The very importance of the case which furnishes the reason that the adversary theory of litigation is not strictly followed, and the acknowledged difficulties and perils of a judicial construction of a law giving it effect under a theory other than that upon which it was designed likewise present sufficient reasons why this Court should not finally dispose of the case without a full presentation by counsel of the point which in view of the Court's opinion becomes the crucial question involved. We submit that these considerations are entitled to special weight in a case such as the instant one in which this Court was so nearly evenly divided; this is particularly true since one of the Justices hereof apparently disqualified himself in one of the cases presented at the same time as the instant case and which was subsequently decided upon the authority of the decision in the instant case.

We submit that counsel could not have been reasonably expected upon the basis of the brief filed on behalf of the petitioners and of prior proceedings in this case to suggest that the tax might be construed as a supplementary corporate income tax and then to brief their arguments as to why such a construction is unsound, and for this Court to fail to hear our arguments upon this point is to insist upon an unduly strict rule of anticipation.

We understand that petitions for rehearing are being prepared by Counsel for F. W. Woolworth Co., and Minnesota Mining and Manufacturing Company in the cases argued with the instant one (Nos. 47 and 48). In order to prevent useless duplication we have not included every point contained in the petitions and briefs to be filed on behalf of such parties but do hereby incorporate by refer-

ence any points made by them which are not included herein.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted and that the judgment of the Supreme Court of Wisconsin be, upon further consideration, affirmed.

Respectfully submitted,

W. H. Dannat Pell
Roswell Dean Pine, Jr.
Attorneys for Respondent.

CERTIFICATE OF COUNSEL

We, W. H. Dannat Pell and Roswell Dean Pine, Jr. counsel for the above named J. C. Penney Company, do hereby certify that the foregoing petition for a rehearing of this case is presented in good faith and not for delay.

W. H. Dannat Pell
Roswell Dean Pine, Jr.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 46.

STATE OF WISCONSIN and ELMER E. BARLOW, as Commissioner of Taxation of the State of Wisconsin,

Petitioners,

vs.

J. C. PENNEY COMPANY, a Delaware Corporation,

Respondent.

BRIEF IN SUPPORT OF PETITION FOR REHEARING

W. H. DANNAT PELL,
ROSWELL DEAN PINE, JR.,
G. BURGESS ELA,
Attorneys for Respondent.

Blank Page

SUBJECT INDEX

TABLE OF CASES

MISCELLANEOUS CITATIONS

Supreme Court of the United States,

OCTOBER TERM, 1940

No. 46

STATE OF WISCONSIN and ELMER E. BARLOW, as Commissioner of Taxation of the State of Wisconsin, *Petitioners*, *vs.* J. C. PENNEY COMPANY, a Delaware Corporation, *Respondent.*	

BRIEF IN SUPPORT OF PETITION FOR REHEARING.

POINT I.

The Privilege Dividend Tax is in its essential effect an income tax upon the stockholders of respondent and as such is unconstitutional with respect to dividends paid to stockholders residing outside of Wisconsin.

The Privilege Dividend Tax directs that the tax be deducted and withheld from the dividends payable by the corporation. In its opinion in *State of Wisconsin ex rel. Froedtert G. & M. Co. Inc.* v. *Tax Commission,* 221 Wis. 225, 265 N. W. 672, 267 N. W. 52 (1936), the Supreme Court of Wisconsin indicated that it thought the instant statute

similar to the New York income tax law involved in *Travis v. Yale & Towne Mfg. Co.,* 252 U. S, 60 (1920), (see 221 Wis. 225 at p. 246).

Provisions for the collection of taxes at the source are common in income tax laws and the fact that a tax is collectible from the creditor of the person taxed and deducted from the amount of the debt does not change its legal effect. See Title 26, U. S. C. Sections 143, 144. Certainly there is no difference in substance between the Privilege Dividend Tax and an income tax upon stockholders collectible by the corporation as the agent of the state. On the other hand, we submit that there are very important differences in substance between the Privilege Dividend Tax and a supplementary corporate income tax.

The majority of this Court does not explain its reasons for believing the tax to be a corporate income tax notwithstanding the deduction provision. The only possible theory upon which it seems to us that this provision could be disregarded is that the stockholder ultimately bears the burden of corporate expenses and accordingly that an express direction that a particular expense be deducted from his dividend instead of disbursed from general corporate funds in the usual manner is immaterial.

The error of such a view is very forcefully presented by Arthur Leon Harding in an article in 25 California Law Review entitled "State Jurisdiction to Tax Dividends and Stock Profits to Natural Persons", in which the author criticizes the opinion of the Supreme Court of Wisconsin in the *Froedtert* case upon the ground that in its opinion in that case the Supreme Court of Wisconsin failed to recognize that the true effect of the law was to impose an income tax upon stockholders. As the reasoning of the author is quite as applicable to the opinion of this Court as to the opinion of the Wisconsin Court, to which it was expressly directed, we quote from it in some detail (page 158):

"Tax on Dividend Based on Power Over Corporation

"Turning to corporate stock we find a similar situation. There is in the beginning an income to the corporation, taxable to the corporation at its place or places of business and in whole or in part at the state of incorporation. A part of this income in turn is passed on to the shareholder in the form of dividends. As such it represents in law an income to the shareholder quite distinct from the income to the corporation. The source of the income to the shareholder (the dividend) is the corporate stock. For a state to claim the right to tax the income on a theory of local source, it would have to establish that this immediate source, the corporate stock, is within its taxing jurisdiction. If this analysis be correct, a dividend representing income to a nonresident shareholder would not be subject to income taxation by a state claiming on the ground that it is the state of incorporation, or that the corporate business and property are located therein. A recent Wisconsin case approaches this issue. The court had previously adopted the approach here set forth, holding as a matter of statutory construction that interest paid a nonresident creditor by a resident debtor is not income from a source within the state. In the instant case the court affirmed its belief in the soundness of that case. Nevertheless, a 2½% tax on dividends was upheld. The reason assigned was that the tax did not purport to be an income tax, or in any way to be a tax upon the dividend or the shareholder, but was an excise tax 'for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in this state.' The excise was to be paid by the corporation and deducted from the dividend. *Right here the real question arises.* Concededly the state may tax domestic or foreign corporations on income derived from business done within the taxing state. Also there would appear to be no objection to measuring this tax by that part of the income distributed as dividends, rather than on the basis of total income. Where only one class

of shares is involved, the amount of the tax, being a proper deduction from profits or surplus before the declaration of dividends, will reduce the available dividend funds. In such a case the shareholder comes out about the same whether the tax is called a franchise tax on the corporation or a tax on the dividends. Within these limits and within them only can the holding of the Wisconsin court be sustained. But suppose the corporation has outstanding an issue of 6% preferred stock. May the directors declare a 6% dividend on the preferred and then declare a dividend on the common, at the same time withholding from the preferred shareholders the 2½% tax? If the Wisconsin statute is, as the court indicates, merely a malformed franchise tax then its amount is deductible from surplus for dividends along with other taxes and is ultimately to come out of the earnings on the common shares. The preferred shareholder would be entitled to his 6% if and when earned, without having his dividend diminished in this way. On the other hand if this be a tax on dividends, and if the state is to be held to have the right to tax the dividend, the right of the corporation to deduct its amount from the 6% declared will have to be upheld. This problem the Wisconsin court does not decide. By torturing the tax into a sort of franchise tax the court saved it in the instant case because, as pointed out, calling it a dividend tax does no real harm except where as here it misleads the taxpayer into instituting fruitless litigation. Legislative labels no longer decide cases. We may concede a certain excise tax jurisdiction. The state may tax the execution of writings within its borders. It may tax sales within its borders. It may tax corporate acts within its borders. However, the liability for such taxes falls upon the person doing the act within the taxing state. There is nothing in this excise tax idea empowering the taxing state as a matter of sovereign authority to create in the taxpayer of first instance a legal right of reimbursement against another person not present in, or acting in, or owning property in, the taxing state. There is nothing in the excise tax idea which would justify the taxpaying corpora-

tion in deducting the 2½% tax from the 6% preferred stock dividend.

"Realizing no doubt the weakness of its position, the Wisconsin court sought to bolster its case by making an argument for local source of the income. It was sought to distinguish dividends from interest payments on the ground that the latter might not be earned by the debtor, and if earned, might be earned outside the taxing state. The dividend tax was applicable only to dividends actually earned within the state. The court in effect disregards the corporate fiction for the sole purpose of applying this tax and argues as though the income to the corporation really accrued to the shareholder in the first instance, while at the same time treating the corporation as a separate entity for other purposes. This 'now you see it—now you don't' handling of the corporate fiction in order to sustain a multiplicity of taxes was proscribed in *Rhode Island Hospital Trust Co.* v. *Doughton,* an inheritance tax case. All the arguments used in the Wisconsin case, e. g., excise tax, tax on transfer as opposed to ownership, ultimate ownership, were advanced and refuted in the *Doughton* case, so that the matter appears to be settled. If some state should abolish the corporate fiction entirely, it would then be able to advance the local source idea with some hope for success."

It will be noted that the author approached the problem from exactly the same viewpoint as that of the majority of this Court, saying: "Legislative labels no longer decide cases". But his conclusion as to the real nature and incidence of the tax is exactly opposite that reached by this Court, and as Mr. Harding's language must be taken to be that of an impartial commentator rather than an advocate, it certainly merits careful study.

We submit that for the purpose of illustrating the difference between a corporate franchise or income tax and the Privilege Dividend Tax the example given by Professor Harding of a corporation having both common and preferred stock outstanding is particularly apt. Let us con-

sider the case of a corporation the income of which is just sufficient to meet the dividend requirements of its preferred stock and to pay a reasonable dividend on its common stock. If the corporate income tax is increased, this increase of corporate expense will result in there being less money available for the payment of dividends upon the common stock. Presumably the dividends upon the preferred stock will not be decreased. Certainly, if the preferred issue is cumulative, the preferred stockholder will be entitled to receive his dividend in full and undiminished by the amount of any tax which the corporation may have to pay before further dividends are paid to common stockholders.

The direction in the Privilege Dividend Tax, however, requiring that the tax be deducted from dividends paid has the effect of casting the incidence of the tax directly upon the preferred stockholder's dividend. Thus, if this tax be deemed a corporate tax, the deduction provision has the effect of destroying the fixed dividend rate to which the preferred stockholder is entitled before any payments are made upon common stock and requiring preferred stockholders to pay from their share of the corporate return a tax which under the corporate contract should be met from the general funds of the corporation. In the case of a foreign corporation the contract of such a preferred stockholder would be a foreign contract. Yet the State of Wisconsin seeks by its jurisdiction to impose a charge upon the corporation, to further require that the charge be paid by the preferred stockholder contrary to such contract. Certainly the State of Wisconsin can have no jurisdiction to require a non-resident preferred stockholder of a foreign corporation to forego his right of priority and to contribute to a corporate tax which under the corporate contract should be paid from general funds. *Royal Arcanam* v. *Green,* 237 U. S. 531 (1915); *Converse* v. *Hamilton,* 224 U. S. 243 (1912); *N. Y. Life Insurance Co.* v. *Head,* 234 U. S. 149 (1914); *Farmers Loan & Trust Co.* v. *Minnesota,* 280 U. S. 204 (1930).

If a preferred stockholder residing outside of Wisconsin files suit in another state contending that a corporate tax has been improperly deducted from his dividend, may the corporation successfully urge as a defense that Wisconsin has modified the corporate contract, when it has jurisdiction of neither the debt nor the person of the creditor and the corporation itself is incorporated in another state? Certainly such a defense would not be sound.

We submit that the above example shows in a manner too plain for controversy that the tax is not an income or franchise tax upon the corporation, but is clearly a personal income tax upon the stockholder. This is the only consistent view. The duty of this Court to sustain state legislation if possible can not be deemed to require it to close its eyes to the true incidence of the tax and call it a supplementary income tax, when it is such in neither fact nor name.

It may be asserted that J. C. Penney Company does not have any preferred stock outstanding and that accordingly it is not entitled to raise this question. We submit that the answer to such an assertion is that we are engaged in construing the law, and in order to determine its true construction are entitled to consider its application to various states of facts whether present in the instant case or not. Obviously the statute may not be construed as a supplementary corporate income tax in the instant case and a personal income tax upon stockholders in the case of a corporation which does have preferred stock outstanding.

The construction of the tax as a corporate tax raises substantially the same difficulty even though a corporation does not have preferred stock outstanding. When J. C. Penney Company declares a dividend it gives rise to a debt of a fixed amount. How in the absence of jurisdiction over the debt or the person of the creditor can the State of Wisconsin constitutionally require J. C. Penney Company to deduct from the stockholder's claim the amount of a tax which this Court has said is imposed upon it? Surely this

is an impairment of the obligation of the stockholder's contract and a failure to give full faith and credit to it as well as a violation of the due process clause.

There is another argument which shows very clearly that the incidence of the tax is upon the stockholder and not upon the earning of income by the corporation. The rate of tax in the law under consideration is 2½%. This rate was subsequently increased to 3%, which is applicable to dividends paid after June 30, 1939. See Chapter 198, Wisconsin Laws of 1939. This means that if a corporation paid out part of its 1935 earnings in 1936, it became liable for a "supplementary income tax" of 2½%, while, if it paid them out after June 30, 1939, it must pay a tax of 3% upon the same earnings. This shows too plainly for controversy that the burden of the tax is not upon the income of the corporation but is upon the income of the stockholder, who, in the case of dividends received after June 30, 1939, pays the higher rate because he received the income in a different tax period. Similarly, the law took effect on September 26, 1935. C. C. H. Corporation Tax Service, Wisconsin, Paragraph 15-001. Corporate income no matter when earned would go untaxed, if received by stockholders as dividends before that date; but, if declared and paid as a dividend after that date, would be taxed. For a ruling of the Wisconsin State Tax Commission which is interesting in this connection see C. C. H. Corporation Tax Service, Wisconsin, Paragraph 19-002.

The question as to whether the Privilege Dividend Tax is imposed upon the corporation or upon its stockholders is one which ultimately must be met. If the tax is a corporate income tax, the corporation is entitled to receive the income tax deductions allowed by federal and state laws for taxes paid. There is a certain inconsistency, however, in giving this deduction to the corporation when the corporation is legally required to pass the tax on to its stockholders.

The United States Treasury Department was called upon to decide whether the stockholder or the corporation was

entitled to the income tax deduction. It decided that the tax was upon the stockholders, saying (I. T. 3002 Cumulative Bulletin, XV-2, p. 142):

> "The title of the law and its provisions show that it was the intention of the state legislature to levy an excise tax on the receipt of dividends and to make the corporation declaring and paying the dividends the collector of the tax for and on behalf of the state by requiring the corporation to withhold the tax from the stockholder and to pay the amount withheld to the State Tax Commission, which in turn pays it into the State Treasury.
>
> "It is held that the Privilege Dividend Tax is an excise tax imposed upon the stockholder receiving the dividend who may deduct the amount of the tax in his Federal income tax return. * * *."

Although we have been unable to find an official ruling by the Wisconsin State Tax Commission under the state income tax law upon this point, the C. C. H. Corporation Tax Service for Wisconsin indicates at Paragraph 10-640.19 that on October 25, 1935, the State Tax Commission wrote a letter to the Corporation Trust Company taking a position in accord with that of the federal tax authorities.

In this connection the construction given to the law by the Wisconsin State Tax Commission in the case under consideration is interesting and significant. In preparing the first assessment against J. C. Penney Company the Tax Commission increased the rate of tax from the statutory rate of .025 to .025641 upon the ground that J. C. Penney Company by its failure to deduct the tax from the dividend, paid a tax which the law placed upon the stockholder and accordingly increased the dividend to that extent (R. 47, 48). It later altered this ruling, but we think it and the others mentioned are particularly pertinent since they represent the rulings of official agencies attempting to determine the incidence of the tax without regard to the description given to it, and in each case the conclusion reached was contrary to that of this Court.

We submit that a careful study of the brief filed on behalf of the State of Wisconsin will show that the analysis of its counsel comes very close to conceding that the tax is an income tax upon stockholders. At page 34 of their brief they say:

> "* * * No one can fairly argue that an excise upon the devolution of dividends is not an appropriate subject of taxation or that in and of itself the imposition of such an excise violates any provisions of the Federal Constitution. In fact such a transfer measures the fruits of corporate earnings transferred from a corporation to its members. And the transfer is fairly subject to a tax which has for its purpose the taxation of Wisconsin corporate earnings at the point they become subject to the enjoyment of those who conduct a corporate business for the purpose of acquiring and distributing such earnings among themselves."

Again they state at page 52:

> "Looking beyond the mere form of things it is evident that the stockholders of a corporation earning money within the State of Wisconsin, under the protection of its laws, for the purpose of distributing that money among themselves, may lawfully be required to pay something for the protection given them by the State of Wisconsin."

These quotations show, as indeed does the language of this Court, that the law is regarded as the exaction of a tax at the time of the accrual of corporate profits to stockholders. *If Wisconsin may not directly impose its income tax upon income payable to nonresident stockholders of a foreign corporation, how possibly can a tax imposed upon the corporation at the time of its payment of a dividend to stockholders, which the corporation is required to deduct from the amount payable to stockholders, be sustained as different in substance?*

We submit that this Court after resolving to ignore the characterization of the tax by the Wisconsin court has itself erred in creating a fictional characterization. The decision of this Court has a strong intellectual appeal in its insistence that constitutionality be determined by trying to pass the physical dimensions of challenged legislation through the doors of propriety as established by the Constitution. It seems to us, however, that in its pursuance of and insistence upon this idea by which it seeks to reformulate certain fields of constitutional law this Court has overlooked certain details of the practical operation of the Privilege Dividend Tax which are here brought to its attention. *If we are to avoid fiction and look to the substance, as this Court has said we must do, the conclusion is absolutely inescapable that the question presented is the jurisdiction of Wisconsin to impose a personal income tax upon nonresident stockholders of foreign corporations and such a tax, we submit, is clearly unconstitutional. Domenech* v. *United Porto Rican Sugar Co.*, 62 Fed. 2d 552 (C. C. A. 1st. 1932) cert. denied 289 U. S. 739; *State Tax on Foreign Held Bonds*, 15 Wall. 300 (1872); *Beidler* v. *South Carolina Tax Commission*, 282 U. S. 1 (1930); *Farmers Loan & Trust Co.* v. *Minnesota*, 280 U. S. 204 (1930); *Newport Co.* v. *Wisconsin State Tax Commission*, 219 Wis. 293, 261 N. W. 884 (1936).

POINT II.

The incidence of the privilege dividend tax is upon the receipt of income by stockholders or upon the dividend transaction and not upon the earning of income.

At pages 36-38 of our original brief we took the position that the incidence of the Privilege Dividend Tax is upon the transaction of declaring and receiving dividends and not upon corporate earnings. The argument there set forth

is that since neither all nor substantially all income earned in Wisconsin is paid out in dividends the incidence of the tax rests upon the dividend transaction which gives rise to the liability, not upon the corporate earning which is remote and has little connection with it. As we have shown, some corporations may earn income in Wisconsin and lose it as a result of unprofitable operations elsewhere or may accumulate their income and later lose it as a result of unprofitable operations in later years.

We would certainly strongly contend that as a straight income tax the State of Wisconsin could not nominally impose a tax upon the earning of corporate income, but stipulate that liability for the tax and the rate paid should be determined (see page 16 hereof) by a declaration of dividends involving such income. So large a percentage of income would escape taxation that the tax could not be said to be reasonably designed as an income tax.

If it be said that the tax is upon Wisconsin income and that it is imposed if and when such income accrues to the enjoyment of stockholders, does this not define it as a tax upon the transaction or an income tax upon stockholders? *A tax may not be saved by naming a relatively unrelated transaction within the jurisdiction of the taxing authority as the subject of tax, if liability for the tax is actually determined by transactions taking place outside of the taxing jurisdiction.* The case resembles the law school tort cases upon the subject of proximate cause. The fact that a man is born is not the proximate cause of an automobile accident in which he may be involved though the accident would never have occurred had he never been born.

The majority of this Court have held, however, that the Privilege Dividend Tax is good because a franchise tax in which dividends paid from local income were taken into account as an element in calculating the value of the privilege taxed, would be valid. Franchise taxes have long been considered to be in a group by themselves. They do not rest upon the power of the state to tax directly the items included in the measure of the tax. In *Educational Films*

Corp. v. *Ward,* 282 U. S. 379 (1931), this Court said at page 392:

> "Having in mind the end sought, we cannot say that the rule applied by this Court for some seventy years, that a non-discriminatory tax upon corporate franchises is valid, notwithstanding the inclusion of tax exempt property or income in the measure of it, has failed of its purpose, or has worked so badly as to require a departure from it now; or that the present tax, viewed in the light of actualities, imposes any such real or direct burden on the federal government as to call for the application of a different rule."

A certain inexactness in the measure has been permitted because the subject was considered proper. The operation of this rule is well illustrated by the recent case of *Ford Motor Co.* v. *Beauchamp,* 308 U. S. 331 (1939), in which this Court upheld a Texas franchise tax measured by a graduated charge upon such proportion of the outstanding capital stock, surplus and undivided profits of the corporation, plus its long term obligations, as the gross receipts of its Texas business bear to the total gross receipts from its entire business. Certainly this tax would not have been valid as an ad valorem tax, yet it was sustained in the form of a franchise tax.

If this Court has now determined to alter the rule laid down in *Educational Films Corp.* v. *Ward,* supra, and to treat the distinction between subject and measure of taxation as legally immaterial, the method adopted in dealing with a particular case must certainly be to consider whether or not the tax is valid as a direct imposition, not to assume that it is because it was formerly considered to be a proper element in the measure of a franchise tax.

The payment of dividends is simply one of the items which courts have held that it is proper to take into consideration in determining the charge to be assessed for the privilege of doing local business. As hereinbefore stated the incidence of the Privilege Dividend Tax is upon the receipt of income by stockholders or upon the dividend trans-

action and not upon the earning of income. Accordingly the fact that the State of Wisconsin may constitutionally tax the income of the respondent is insufficient to sustain the instant tax.

POINT III.

Practical aspects of the Privilege Dividend Tax.

A. The Privilege Dividend Tax was expressly designed to perpetuate an income tax deduction pursuant to which stockholders of local corporations avoid liability for the progressive personal income tax and surtax on dividends received, not to remedy this situation as might be implied from the opinion of this Court.

In their decision the majority of this Court said:

> "* * * The tax now assailed gains nourishing significance when placed in the context of the Wisconsin taxing system of which it became a part. Wisconsin relied heavily upon taxation of incomes and largely looked to this source to meet the increasing demands of the depression years. But a special Wisconsin feature was exemption of dividends from personal taxation. See Welch *v.* Henry, 305 U. S. 134, 142-43. This exemption persisted while regular and surtax rates against personal incomes were raised. Attempts at relief from the unfairness charged against this exemption of dividends, particularly advantageous to the higher brackets, were steadily pressed before the Wisconsin Legislature. To relieve local earnings of foreign corporations from a dividend tax would have had a depressive effect on wholly local enterprises. The Privilege Dividend Tax was devised to reduce at least in part the state's revenue losses due to dividend exemptions, and also to equalize the burdens on all Wisconsin earnings, regardless of the formal home of the corporation."

In the light of this language let us examine the tax structure to which this Court has referred. It is true that in

certain cases dividends paid by corporations are not taxable to the stockholder. The provisions of the Wisconsin income tax law dealing with dividends were summarized by this Court in *Welch* v. *Henry*, 305 U. S. 134, as follows:

> "Wisconsin income tax legislation has from the beginning treated dividends received from corporations deriving a substantial part of their income from business carried on within the State, on which the corporations have paid a tax to the State, as a distinct class of income for tax purposes. At first complete tax immunity was granted to them. § 1, c. 658, Laws of Wisconsin, 1911. Later the immunity was allowed ratably in the same proportion that the income of the corporation had been subjected to state income tax. § 1, c. 318, Laws of Wisconsin, 1923. *And, finally, by amendment adopted in 1927 and in force in 1933 complete immunity of dividends from income tax was allowed if 50% or more of the total net income of the corporation paying them was included in the computation of the Wisconsin tax on corporate income*" (p. 142). (Emphasis ours.)

From this it will be noted that the deduction is allowed to stockholders only in case more than fifty percent of the net income of the corporation is attributable to Wisconsin. This means, of course, that the exemption is not applicable to stockholders of respondent which receives between three and four percent of its total income from Wisconsin.

Apparently when the state required further revenue in 1935 the progressive tax on dividends received by stockholders in the year 1933, which was involved in the case of *Welch* v. *Henry*, 305 U. S. 134 (1938), was passed. This law was effective only with respect to dividend income for one year, the Privilege Dividend Tax being designed to take its place. It is obvious that the Privilege Dividend Tax was designed in order to retain a favored treatment for stockholders of domestic corporations (receiving more than fifty percent of their income from within the state) and yet at the same time to obtain a single small income tax on

dividends accruing to such stockholders. The income accruing to stockholders of most foreign corporations residing in Wisconsin bears three income taxes (corporate income, Privilege Dividend and personal income), while that of stockholders of most domestic corporations bears only two (corporate income and Privilege Dividend). The tax has the effect of imposing a double personal income tax upon resident stockholders of foreign corporations, yet, because of the deduction of one of the taxes at the source, the stockholder does not realize quite as clearly as he otherwise might that he is paying two taxes. The law, also, of course, has the virtue from the Wisconsin tax viewpoint of levying an imposition upon revenue going to non-resident stockholders of foreign corporations which would otherwise have been lost for tax purposes. If the States in which such non-resident stockholders reside impose an income tax, this income likewise bears three taxes.

From the foregoing it is plain that when the question of obtaining further revenue came before the Wisconsin legislature and exempt dividends of domestic corporations were suggested as a likely source of additional revenue, a scheme was devised which satisfied the state because it secured the revenue required and likewise satisfied the holders of large blocks of stock in local enterprises because they avoided the payment of the progressive income tax and the surtax which otherwise would almost certainly have been required. In other words, a compromise was entered into between politically potent Wisconsin interests at the expense of the stockholders of corporations such as the respondent which conduct less than half of their business within the state. *The Privilege Dividend Tax was designed not to correct the unfairness in regard to surtaxes mentioned by this Court, but to expressly perpetuate it.* For a further indication of the manner in which this law discriminates against foreign corporations see *Appeal of Cleaf Corporation*, C. C. H. Corporation Tax Service Wisconsin Par. 19-040 (Wisconsin Tax Commission 1939).

It seems possible to us that this Court in delivering its opinion may not have fully understood the exact terms of the dividend deduction permitted in the Wisconsin income tax law and its effect and we submit that this exposition should go far to destroy any particular significance which this Court may have discovered in considering the Privilege Dividend Tax in connection with the Wisconsin income tax system.

B. The Privilege Dividend Tax is Highly Impractical and Imposes an Extremely Severe and Uneconomic Burden Upon Corporations Such as the Respondent.

One of the principal reasons of respondent for bitterly contesting this law is the entirely unreasonable burden which the law casts upon it. This point has not been briefed though it has been asserted by respondent as a basis of invalidity of the law (R. 60). If Wisconsin has jurisdiction to impose the tax the burden imposed upon respondent seems at first glance to be little different from that imposed by sales tax laws upon vendors of merchandise. Actually, however, because of the extremely small sums and large number of calculations involved, the practical burden imposed upon respondent and other corporations similarly situated is very great in comparison to the sums realized by the state from the tax. We respectfully urge that the imposition of this burden is a violation of the due process clause of the United States Constitution.

While there is no evidence in the record, it is common knowledge of which this Court may take judicial notice that corporations whose stock is sold on stock exchanges for a number of years tend to have their stock held in many cases by persons holding small blocks of five, ten, fifteen, twenty and twenty-five shares. This is true because small investors do not have a great deal to invest and ordinarily wish to diversify their holdings. Furthermore, large blocks of stock owned by the original organ-

izers of an enterprise tend to become split up as a result of gifts and the distribution of estates among numerous next of kin or legatees. Some idea of the dispersion which takes place can be gained by a reference to Exhibit 5 opposite R. 50 showing the dispersion of respondent's stockholders over the forty-eight states of the Union. Furthermore it will be noted that on each successive dividend date the number of stockholders was greater.

In order to demonstrate in a concrete way the burden imposed upon respondent by this law, let us determine the amount of tax deductible from the regular quarterly dividend of seventy-five cents in the case of a five share block of J. C. Penney Company stock. The stockholder is entitled to receive a total of $3.75. In 1936 according to the presumption about 3.9% of this was attributable to Wisconsin earnings; thus the total alleged Wisconsin earnings entering into the dividend were about 14½¢ upon which the corporation was required to assess a tax of 2.5%. On this five share block, therefore, the tax would be about $0.00365. It is plain that in such a case a deduction would be impossible. It would require a fifteen share block of stock having a present market value of about $1300 before the dividend deduction would amount to 1¢. The large number of stockholders of the respondent renders it apparent that there must be a great number of stockholders who own five, ten or fifteen share blocks of stock. It must be clear that the task of making equitable deductions would be exceedingly difficult.

Unfortunately there is likewise nothing in the evidence to show in any exact way the accounting costs which must necessarily be imposed upon the corporation. It is difficult to imagine, however, that a corporation could hire employees to take care of calculating and deducting the tax at less than three to five cents a transaction. If we assume that the cost is four cents per transaction it means that except in cases of blocks of stock of more than sixty shares, it costs the corporation more to make the deduction than the

state receives in taxes. This also involves a troublesome situation. The corporation might make the deduction in the case of large stockholders and not in the case of small ones, but this policy is hardly fair and would almost certainly involve it in difficulties with the large stockholders. On the other hand, if the corporation does not make the deductions at all, it cannot under federal and state rulings get the benefit of income tax deductions for taxes paid and must run the risk of attack from stockholders upon this ground.

By this time persons associated with corporate management are pretty well reconciled to the fact that corporate taxes may be expected to be high and burdensome. Most large corporations have departments containing a number of employees whose sole duties are to compile the necessary figures for and prepare tax returns required by federal, state and city tax laws. If the Privilege Dividend Tax were in fact a supplemental corporate income tax, it could be administered entirely upon the basis of returns already required and would not be nearly so objectionable. From the foregoing, however, it is plain that instead of being an economic exaction designed to obtain the largest amount of revenue with the least confusion, its practical effect is to obtain a relatively small amount of revenue in comparison to the additional corporate expense entailed.

This Court has shown considerable reluctance to overthrow a piece of poorly designed and drawn state legislation upon the theory that in this decade of high governmental expenses legislative efforts to raise the revenue required should not be hampered. It must be clear, however, that the economic waste entailed in declaring this uneconomic law unconstitutional and requiring the state to adopt a proper plan of taxation, as it unquestionably may under the decisions of this Court, is far less than that involved in requiring the respondent and other corporations to increase their staffs to comply with this law and to face the same situation again and again as other state legislatures searching for additional "painless and hidden"

sources of revenue may be led by the precedent of this case to enact similar laws.

We respectfully submit that the judgment of this Court should be vacated and the judgment of the Supreme Court of Wisconsin should be affirmed.

W. H. DANNAT PELL
ROSWELL DEAN PINE, Jr.
G. BURGESS ELA,
Attorneys for Respondent.

-P S

SUPREME COURT OF THE UNITED STATES.

No. 46.—October Term, 1940.

State of Wisconsin and Elmer E. Barlow as Commissioner of Taxation of the State of Wisconsin, *vs.* J. C. Penney Company.	On Writ of Certiorari to the Supreme Court of the State of Wisconsin.

[December 16, 1940.]

Mr. Justice Frankfurter delivered the opinion of the Court.

Whether the tax imposed by § 3 of Chapter 505 of the Wisconsin Laws of 1935 may apply to a foreign corporation licensed to do business in Wisconsin without offending the Fourteenth Amendment of the Constitution is the question before us. The statute is quoted in the margin.[1] When this question originally came before the Supreme Court of Wisconsin it found no constitutional infirmity in such an exaction. *State ex rel. Froedtert G. & M. Co.* v. *Tax Commission*, 221 Wis. 225. But deeming itself constrained by its reading of this Court's decision in *Connecticut General Co.* v. *Johnson*, 303 U. S. 77, the Wisconsin Supreme Court in the present case found that the statute ran afoul the Due Process Clause insofar as it covered locally licensed foreign corporations. 233 Wis. 286.

---

[1] Section 3, Chapter 505, Laws of Wisconsin, 1935, as amended by Chapter 552, Laws of Wisconsin, 1935:

"Section 3. Privilege Dividend Tax. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to two and one-half per centum of the amount of such dividends declared and paid by all corporations (foreign and local) after the passage and publication of this act and prior to July 1, 1937. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation.

"(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

"(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof

Inasmuch as important issues affecting the exertion of the taxing power of the states are involved, we brought this and its companion cases here. 310 U. S. 618, 619.

For many years, corporations chartered by other states but permitted to carry on business in Wisconsin have been subject to a general corporate income tax act on earnings attributable to their Wisconsin activities. The state has, of course, power to impose such a tax. *U. S. Glue Co.* v. *Oak Creek*, 247 U. S. 321; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113. "For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in" Wisconsin, an exaction "equal to two and one-half per centum of the amount of such dividends declared and paid by all corporations (foreign and local)" is the additional tax now before us. In the enforcement of this measure against foreign corporations, the amount of income attributable to Wisconsin is calculated according to the same formula as that employed in assessing the general corporate income tax paid by such foreign corporations. The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax

to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

"(5) Dividends paid by a subsidiary corporation to its parent shall not be subject to the tax herein imposed provided that the subsidiary and its parent report their income for taxation under the provisions of chapter 71 on a consolidated income return basis, or both corporations report separately.

"(6) The provisions of this section shall not apply to dividends declared and paid by a Wisconsin corporation out of its income which it has reported for taxation under the provisions of chapter 71, to the extent that the business of such corporation consists in the receipts of dividends from which a privilege dividend tax has been deducted and withheld and the distribution thereof to its stockholders.

"(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

"(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

"(9) The tax hereby imposed shall, when collected by the tax commission, be paid by it into the state treasury."

Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.

As pressures for new revenues become more and more insistent, ways and means of meeting them present to a state not only the baffling task of tapping fresh sources of revenue but of doing so with due regard to a state's existing taxing system. The tax now assailed gains nourishing significance when placed in the context of the Wisconsin taxing system of which it became a part. Wisconsin relied heavily upon taxation of incomes and largely looked to this source to meet the increasing demands of the depression years. But a special Wisconsin feature was exemption of dividends from personal taxation. See *Welch* v. *Henry,* 305 U. S. 134, 142-43. This exemption persisted while regular and surtax rates against personal incomes were raised. Attempts at relief from the unfairness charged against this exemption of dividends, particularly advantageous to the higher brackets, were steadily pressed before the Wisconsin Legislature. To relieve local earnings of foreign corporations from a dividend tax would have had a depressive effect on wholly local enterprises. The Privilege Dividend Tax was devised to reduce at least in part the state's revenue losses due to dividend exemptions, and also to equalize the burdens on all Wisconsin earnings, regardless of the formal home of the corporation.

Had Wisconsin, as part of its price for the privileges it afforded foreign corporations within its borders, explicitly provided for a supplementary tax on the Wisconsin earnings of such corporations, but postponed liability for the tax until such earnings were to be paid out in dividends, the power of Wisconsin to do so would hardly be questioned. Compare *Continental Assurance Co.* v. *Tennessee,* No. 117 this Term, decided Oct. 21, 1940. But because the legislative language ran "For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state" the court below raised the barrier of the Fourteenth Amendment. Respondent is a Delaware corporation having its principal offices in New York; its meetings are held in the latter state where the dividends are voted and the dividend checks are drawn on New York bank accounts. Since the process for declaring dividends and the details attending their distribution among the stockholders transpired outside Wisconsin, al-

though the exaction was apportioned to the earnings derived from Wisconsin, the state court concluded that the tax was an attempt by Wisconsin to levy an exaction on transactions beyond Wisconsin's borders.

The case thus reduces itself to the inquiry whether Wisconsin has transgressed its taxing power because its supreme court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax on the privilege of declaring dividends rather than a supplementary income tax.

A tax is an exaction. Ascertainment of the scope of the exaction—what is included in it—is for the state court. But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction. "In whatever language a statute may be framed, its purpose must be determined by its natural and reasonable effect." *Henderson v. Mayor of N. Y.*, 92 U. S. 259, 268. Such has been the repeated import of the cases which only recently were well summarized by the guiding formulation for adjudicating a tax measure, that "in passing on its constitutionality we are concerned only with its practical operation, not its definition or the precise form of descriptive words which may be applied to it". *Lawrence v. State Tax Commission*, 286 U. S. 276, 280.

The Constitution is not a formulary. It does not demand of states strict observance of rigid categories nor precision of technical phrasing in their exercise of the most basic power of government, that of taxation. For constitutional purposes the decisive issue turns on the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society.

Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary rather than the text. We cannot, however, be too often reminded that the limits on the otherwise autonomous powers of the states are those in the Constitution and not verbal weapons imported into it. "Taxable event", "jurisdiction to tax", "business situs", "extra-

territoriality", are all compendious ways of implying the impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state. The simple but controlling question is whether the state has given anything for which it can ask return. The substantial privilege of carrying on business in Wisconsin, which has here been given, clearly supports the tax, and the state has not given the less merely because it has conditioned the demand of the exaction upon happenings outside its own borders. The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction. See *Continental Assurance Company* v. *Tennessee, supra.* See also *Equitable Life Society* v. *Pennsylvania,* 238 U. S. 143; *Maxwell* v. *Bugbee,* 250 U. S. 525; *Compañia de Tabacos* v. *Collector,* 275 U. S. 87, 98; *New York ex rel. Cohn* v. *Graves,* 300 U. S. 308; *Atlantic & Pacific Tea Co.* v. *Grosjean,* 301 U. S. 412; *Atlantic Refining Co.* v. *Virginia,* 302 U. S. 22; *Curry* v. *McCanless,* 307 U. S. 357.

This analysis is merely a reformulation of the classic approach of this Court to the taxing power of the states. *Lawrence* v. *State Tax Commission, supra,* p. 280. Ambiguous intimations of general phrases in opinions torn from the significance of concrete circumstances, or even an occasional deviation over a long course of years, not unnatural in view of the confusing complexities of tax problems, do not alter the limited nature of the function of this Court when state taxes come before it. At best, the responsibility for devising just and productive sources of revenue challenges the wit of legislators. Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject themselves in a merely negative way into the delicate processes of fiscal policy-making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but

merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize.

Nor does *Connecticut General Co. v. Johnson, supra,* present a barrier against what Wisconsin has done. Its presuppositions recognize the scope of the state taxing power we have outlined. 303 U. S. 77, 80, 82. In the precise circumstances presented by the record it was found that the tax neither in its measure nor in its incidence was related to California transactions. Here, on the contrary, the incidence of the tax as well as its measure is tied to the earnings which the State of Wisconsin has made possible, insofar as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes. See, for instance, his dissent in *Compañia de Tabacos v. Collector, supra,* p. 100.

Because the Wisconsin Supreme Court found the statute to be invalid as to foreign corporations in the position of the respondent it had no occasion to pass on certain claims relating to the application of the statute to the specific dividends here involved. We therefore remand the case for the determination of such questions as are open in the light of this opinion.

Reversed and remanded.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

No. 46.—October Term, 1940.

State of Wisconsin and Elmer E. Barlow, as Commissioner of Taxation of the State of Wisconsin, Petitioners, *vs.* J. C. Penney Company.	On Petition for Writ of Certiorari to the Wisconsin Supreme Court.

[December 16, 1940.]

Mr. Justice Roberts.

I assume that the principle still holds good that a state, a member of the sisterhood of states in the Republic, cannot extend her sovereignty by legislation so as to prohibit, to regulate, or to tax property or transactions of citizens of other sovereign states lying outside her boundaries and regulated by the law of the state of domicile or residence. I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders. Those activities which have a real and substantial relation to the business transacted by the citizen of another state within her confines are, of course, subject to regulation and to taxation. It would be mere affectation to cite the adjudications of this court which are founded upon these propositions. I have thought that these principles were of the very warp and woof of the constitutional system which binds the states together in a federal union. Attempted transgressions of these limits of state sovereignty have time and again run afoul of the Fourteenth Amendment.

The respondent admittedly receives income in Wisconsin. No one questions the power of Wisconsin to lay a tax upon the receipt of that income. It has done so. It is said that the challenged exaction is merely an additional income tax,—this, notwithstanding

that the tax is not called an income tax, has been held by the highest court of Wisconsin not to be an income tax but an excise upon a privilege,—in the view that in testing the constitutionality of an exaction this court examines for itself the nature and incidence of the tax and disregards mere names and descriptive epithets. With that principle I have no quarrel, but I think the opinion of the court demonstrates that the tax here in question is, and can be, sustained only by a disregard of it. Let me illustrate my meaning. Assuming that, by statute, an ad valorem tax on property is prohibited and an income tax permitted. The terms used in the statute necessarily have a conventional connotation. One cannot intelligently discuss things or actions except by using the names commonly employed to describe them. Concepts of ad valorem taxation on property and taxation of income are clear and easily discriminable. What would be said of a decision construing such a statutory provision so as to hold a tax of so many cents on the dollar upon property an income tax because, forsooth, all the property assessed has been received as the fruits of labor, of industry, or of capital, upon the theory that, as the property had come into existence at some remote date as income, the tax was an income tax? I think that is precisely what has been done in this case.

The facts are not in dispute. The respondent receives income in many states. That income is forwarded to its home office after bearing whatever tax is laid upon its receipt in the state of receipt. Thereupon the funds so forwarded become a portion of the general mass of the respondent's property, held and administered at its general office. The funds may be employed in the extension of its business; they may be held as insurance against future business losses or they may be distributed to its stockholders in dividends. Their management and their disbursement have no relation to the original receipt of income save only the fact that, like most property, they are built up as the fruits of income. Their use and their disbursement does not depend on any law of Wisconsin and cannot be controlled by any such law. The act of disbursing them, whether in payment of corporate obligations or as dividends, is one wholly beyond the reach of Wisconsin's sovereign power, one which it cannot effectively command, or prohibit or condition. That distribution cannot be the subject of an excise tax by the State of Wisconsin. So much the state admits.

Under the challenged statute, a presumption is created which is shown in the case of the assessment against the respondent for the years in question to be contrary to the fact,—namely, that an arbitrarily assumed proportion of the dividend is paid out of the respondent's earnings in Wisconsin for the year immediately preceding the payment of such dividend. By the very terms of the Act, the tax is laid not on the corporation but on the stockholder receiving the dividend and, by confession, thousands of such stockholders are not residents of Wisconsin. The corporation is the mere collector of the tax and the penalty for failure to collect it is that the corporation must pay it. If the exaction is an income tax in any sense it is such upon the stockholder and is obviously bad. It cannot, except by a perversion of the term and the affixing of an arbitrary label, be denominated a tax upon the income of the respondent.

The explanation of the reason and purpose for imposing the tax, disclosed in the opinion of the court, serves to condemn it. If Wisconsin found that dividend income of stockholders of domestic corporations escaped taxation, and should bear it, an effective way to reach the dividend receipts of the stockholders of such corporations was to place a tax upon the receipt of dividends by them. But such a levy upon the stockholders of a foreign corporation, not resident within Wisconsin, obviously was impossible although that is exactly what was attempted by the statute in question. We are now told that this is not a fair exposition of the law but that, on the contrary, and in the teeth of the known facts, what Wisconsin did was to lay a supplementary income tax upon foreign corporations. This is simply to take the name of a well understood concept and assign that name as a label to something which in ordinary understanding never fell within such concept. By this process any exaction can be tortured into something else and then justified under an assumed name.

The respondent owns property in various states of the Union. It is reasonable to suppose that much of that property has been purchased out of corporate surplus, that is, out of past earnings. An ad valorem tax by Wisconsin on property so acquired could be quite as easily justified under the label of an income tax because the property represented income once received, as the present tax, on the declaration and receipt of dividends out of earned surplus.

Upon the facts, the tax is levied on what lies outside the sovereignty of Wisconsin. Its attempted collection is a violation of

the Due Process Clause of the Fourteenth Amendment and should be stricken down.

The Supreme Court of Wisconsin could not have decided otherwise in the light of a recent expression of this court on the subject. In reaching its decision it professedly followed and applied *Connecticut General Life Insurance Co.* v. *Johnson,* 303 U. S. 77. There a Connecticut life insurance company did business in California under license from that state. It entered into contracts with other insurance companies, also licensed to do business in California, reinsuring them against loss on policies written by them in California on the lives of California residents. The contracts were made in Connecticut, premiums were paid there, and the losses, if any, were there payable. California imposed a tax upon the privilege of the company to do business within California. The tax was measured by the gross premiums received. California officials attempted to collect the tax on the premiums received by the Connecticut corporation under the reinsurance contracts in question. The Supreme Court of California sustained the tax. In that case, as in this, the highest state court described and defined the tax. There the tax was denominated "a franchise tax enacted for the privilege of doing business in the state." Here, the Supreme Court of Wisconsin has denominated the exaction as a privilege or excise tax imposed upon the transfer of property. By the very process the court now professes to employ of disregarding the name given to the tax by the state court, this court, in the *Connecticut General Life Insurance Co.* case, reached the conclusion that the State of California could not impose the tax on the activities of the Connecticut company which were not within its jurisdiction. Citing many decisions of this court, it was there said:

"But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state."

The very argument now invoked in support of the present decision was repudiated by the court in the *Connecticut* case in these words:

"It is said that the state could have lawfully accomplished its purpose if the statute had further stipulated that the deduction should be allowed only in those cases where the reinsurance is

effected in the state or the reinsurance premiums paid there. But as the state has placed no such limitation on the allowance of deductions, the end sought can be attained only if the receipt by appellant of the reinsurance premiums paid in Connecticut upon the Connecticut policies is within the reach of California's taxing power. Appellee argues that it is, because the reinsurance transactions are so related to business carried on by appellant in California as to be a part of it and properly included in the measure of the tax; and because, in any case, no injustice is done to appellant since the effect of the statute as construed is to redistribute the tax, which the state might have exacted from the original insurers but did not, by assessing it upon appellant to the extent to which it has received the benefit of the allowed deductions."

In describing the incidence of the void tax this court said, as it might with equal accuracy be said of the instant tax:

"Apart from the facts that appellant was privileged to do business in California, and that the risks reinsured were originally insured against in that state by companies also authorized to do business there, California had no relationship to appellant or to the reinsurance contracts. No act in the course of their formation, performance or discharge, took place there. The performance of those acts was not dependent upon any privilege or authority granted by it, and California laws afforded to them no protection."

And finally the court concluded:

"All that appellant did in effecting the reinsurance was done without the state and for its transaction no privilege or license by California was needful. The tax cannot be sustained either as laid on property, business done, or transactions carried on within the state, or as a tax on a privilege granted by the state."

I think that the judgment below should be affirmed.

The CHIEF JUSTICE, Mr. Justice MCREYNOLDS and Mr. Justice REED concur in this opinion.

END